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Yen Rides Roller Coaster In 1990

For the yen 1990 represented disaster avoided. During 1989 the Japanese currency had showed unexpected weakness. Its slide continued into the first few months of 1990. During a few grim days in early April some observers felt that Japanese financial markets threatened to reel out of control. The stock market plunged, interest rates soared and the yen plummeted to as low as Y159.8=$1.00, a level not seen in three years. But even in the midst of this apparent crisis Japanese economists pointed out that the economy still was strong and that labor markets, if anything, were too tight. They suggested that financial markets had overreacted to a relatively small change in Bank of Japan monetary policy that had led to higher interest rates. This view implied that key financial indicators soon could reverse themselves.

By year's end these economists had been proven at least one-third correct. Although interest rates showed a mixed pattern at best and the stock market sank further during the second half of the year, the Japanese currency righted itself and then some. As a result, it finished 1990 stronger than it was December 31, 1989 -- although the turbulence earlier in the year and renewed weakness at yearend were enough to keep the yen's 1990 average value

below that of 1989's (see Table 1). And despite the currency's broad swing during 1990, the recent pattern of diminishing year-to-year variation continued; the 4.7 percent depreciation of the yen between 1989 and 1990 was the smallest percentage move in either direction since 1985.

Table 1: Yen-Dollar Exchange Rate, 1985-90

(monthly average, Tokyo interbank market)

	1985	1986	1987	1988	1989	1990
January	Y254.1	Y200.0	Y154.5	Y127.6	Y127.2	Y145.1
February	260.3	184.6	153.5	129.2	127.8	145.5
March	258.4	178.8	151.5	127.3	130.4	153.1
April	251.7	175.6	143.0	125.0	132.1	158.5
May	251.6	166.9	140.5	124.8	138.4	153.5
June	249.0	167.8	144.5	127.1	143.8	153.8
July	241.7	158.7	150.2	133.1	140.7	149.3
August	237.2	154.1	147.6	133.6	141.1	147.4
September	236.9	154.8	143.0	134.4	145.1	139.0
October	214.8	156.0	143.5	129.0	141.9	129.7
November	203.9	162.7	135.3	123.2	143.5	129.1
December	202.8	162.1	128.4	123.6	143.6	133.7
Annual Average	238.5	168.5	144.6	128.2	138.0	144.8

The Japanese currency's low in April culminated a decline that in retrospect appears to have begun in November 1988. For 1991 the obvious question is whether the yen's newfound strength will be as durable as was its weakness, which lasted 17 months. American analysts are sharply divided on this point. Of 40 economists surveyed by the Wall Street Journal in early January on the value of the yen at the end of 1991, 19 expected the yen to appreciate compared to its 1990 closing value, while 21 said it would decline; the average forecast of Y138=$1.00 was very close to the December 31 figure of Y135.8. No one expected the yen to break through the Y120 barrier for a sustained period, even though it has approached that level three times since 1987. Given the distinct possibility that another long yen swing may have begun in May, this outcome should not be discounted.

Japanese experts appear to be somewhat more optimistic about the yen. An early January survey by Nihon Keizai Shimbun, widely regarded as the Journal's Japanese counterpart, asked slightly different questions than in the U.S. survey, but the responses implied an average forecast of Y134.1=$1.00 (obtained by calculating the midpoints of the expected range of values over 1991). Of the 47 forecasters queried, 19 expected the Japanese currency to cross the Y120 threshold at some point during 1991.

A look at what the Japanese currency did against currencies other than the dollar last year (see Table 2) gives credence to the case for a strong yen. In 1990 the yen continued to sink against European currencies, which increasingly are linked to each other. The yen's yearend value against the Deutsche mark was the lowest since 1982. Economic fundamentals would appear to warrant

Table 2: Changes in the Yen Against Selected Currencies, 1989-90

(other currencies in terms of yen at yearend)

	1989	1990	Percent Change
German Deutsche mark	Y85.18	Y90.84	-6.2%
British pound	232.30	262.09	-11.4
Canadian dollar	124.27	117.07	6.2
Australian dollar	113.68	104.91	8.4
Korean won	0.21	0.19	11.8
Singapore dollar	75.74	78.25	-3.2
Taiwan dollar	5.52	5.10	8.3
Hong Kong dollar	18.44	17.41	5.9
U.S. dollar	143.91	135.80	6.0

much greater strength against European currencies. Thus, absent a strengthening of the dollar against the Deutsche mark, the yen should appreciate against both the dollar and European currencies.

The table also indicates how the yen performed on a year-to-year basis against some of its important Asian counterparts. Except for the Singapore dollar, the yen rose a comparable amount against the dollar and the Asian currencies listed. As such, the pattern was similar to, but the reverse of, 1989's. That year the yen dropped against all the indicated Asian currencies as well as the dollar. This outcome suggests that, through market forces or government action, Asian exchange rates remain more closely linked to the American currency than to the Japanese one. It also implies that Asian currencies are likely to depreciate against the yen should the yen strengthen against the American dollar.

Currency traders, of course, play political and economic prophet in taking exchange rate positions; as such, current exchange rates reflect a consensus among traders as to future developments. Currency forecasters make similar judgments; for this reason projected exchange rates are likely to approximate current levels. Neither traders nor forecasters can claim unusual clairvoyance, however, and the current economic and political environment has created unusually cloudy crystal balls.

For example, an American recession more severe than now predicted would raise the demand for foreign capital to finance a federal budget deficit that would grow beyond expected levels; that would boost the dollar. Just the reverse also is possible; if the recession turns out to be short, capital demands could be modest, lowering the value of the dollar below analysts' current best guesses. A prolonged Middle East conflict by itself probably would lift the dollar by increasing the demand for borrowed funds to wage war, but inflationary forces unleashed by a combination of higher oil prices and inappropriate monetary responses to changing fiscal conditions could weaken the American currency. For these reasons few people should be surprised to see big swings in the yen-dollar exchange rate during 1991 as traders weigh the likelihood of these contradictory scenarios.

Douglas Ostrom

NOTE

ONLY THE FOLLOWING PAGES OF THIS

PUBLICATION HAVE BEEN FILMED

Film Entire Issue